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In the Supreme Court of the United States

OCTOBER TERM, 1949.

No. .....

In the matter of:
FOREST CITY BREWERY, INC.
Bankrupt.

JEROME N. CURTIS,
Trustee in Bankruptcy,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Claimant-Respondent.

PETITION FOR WRIT OF CERTIORARI
To The United States Court of Appeals
For the Sixth Circuit.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioner prays that a writ of certiorari issue to review the order of the Circuit Court of Appeals for the Sixth Circuit entered on December 12, 1949, reversing the decree of the United States District Court for the Northern District of Ohio, Eastern Division, entered on January 3, 1949.

OPINION BELOW.

The opinion of the Court below filed December 12, 1949, is as follows:

Per Curiam. Upon stipulated facts, the district court affirmed an order of the Referee in Bankruptcy which disallowed the claim of the United States for a sum certain, due under Section 1622 of the Internal Revenue Code, as amended, as income withholding taxes upon amounts directed by the referee to be paid to certain claimants as wages out of available funds in the bankrupt's estate.

The government has appealed from the order, and relies upon the direct authority of *United States v. Fogarty*, 164 F. (2d) 26 (C. A. 8), wherein it was held that a trustee in bankruptcy who makes payments in respect of wages earned by the bankrupt's employees before the bankruptcy is an employer for income withholding tax purposes and is liable for the payment of such taxes where there is no proof that the wage earners had paid sufficient income taxes to discharge the withholding taxes. This holding was based upon Section 1622(a) of the Internal Revenue Code, as added by Section 2 of the Current Tax Payment Act, which requires an employer making payment of wages to deduct and withhold therefrom a tax equal to the amount specified in the statute, and of Section 1623, placing liability upon the employer for payment of taxes so required to be deducted and withheld.

The Referee in Bankruptcy whose ruling was adopted by the district judge conceded in his opinion that there is no doubt that *United States v. Fogarty, supra,* sustains the government's position; but, for the reason that this Court had not decided the question, he considered himself free to disagree with the reasoning and conclusions of the Court of Appeals for the Eighth Circuit.

After careful consideration of the soundly reasoned opinion of the Court of Appeals for the Eighth Circuit and the divergent view of the experienced referee in bankrupt-

cy, we are of opinion that *United States v. Fogarty* was correctly decided; and, therefore, concur in the opinion of the Court of Appeals with respect to the duty and liability of the trustee in bankruptcy to withhold the specified income taxes upon claims for wages earned prior to the bankruptcy. We do not reach the question, nor do we base our decision or express any opinion upon the added conclusion of the Court of Appeals for the Eighth Circuit that the taxes are enforceable against the estate of the bankrupt as expences of administration having priority under Section 64(a) of the Bankruptcy Act.

The judgment of the district court is reversed, with direction that the claim of the United States for the withholding taxes involved be allowed.

BASIS OF JURISDICTION.

Jurisdiction is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925, 43 Stat. 938.

QUESTIONS PRESENTED.

1. The fundamental question is whether a trustee in bankruptcy who, on order of the Bankruptcy Court, pays dividends on wage claims of former employees of the bankrupt (which claims are entitled to priority in payment under Section 64a(2) of the Bankruptcy Act) is liable for payment of income withholding tax imposed by Section 1622 of the Internal Revenue Code.

To resolve the issue above, it is necessary to determine these questions:

2. Is Section 1622 of the Internal Revenue Code now engrafted upon Section 64a of the Bankruptcy Act, thereby adding a new class of claims entitled to priority of payment?

3. Is Section 57n of the Bankruptcy Act, which requires filing of proofs of claim within six months of the

first meeting of creditors, and which applies to all taxing authorities, now rendered inapplicable to income withholding taxes?

4. If such taxes are entitled to priority of payment under Section 64a of the Bankruptcy Act by reason of Section 1622 of the Internal Revenue Code, are they now to be classed as costs of administration under Section 64a(1), as assigned wage claims under Section 64a(2), or as neither?

5. Do Sections 1621 and 1622 of the Current Tax Payment Act of 1943 apply to dividends paid out of a bankruptcy estate on wage claims of former employees of the bankrupt?

SUMMARY STATEMENT.

In July 1939, Forest City Brewery Inc. filed a petition under Chapter XI of the Bankruptcy Act. Failing to accomplish an arrangement under that chapter, an adjudication in bankruptcy was entered and the proceeding continued as a conventional bankruptcy liquidation.

A total of 117 claimants filed claims in 1939 for wages earned prior to July, 1939, claiming priority therefor under Section 64a(2) of the Bankruptcy Act. All such wage claims filed were allowed as claims entitled to priority under said section in varying amounts.

The case was closed in 1940. In 1945, the case was reopened for purpose of recovering assets and referred to the Referee. A substantial recovery was made by the new trustee. As a result of such recovery, a fund became available for distribution, without deduction for the taxes in question, in an amount sufficient to distribute 43.8% on the wage claims. The Referee ordered payment thereof.

On March 19, 1948, the Government filed its claim for withholding tax on the proposed aggregate wage claims dividends aforesaid, in the sum of $663.10. By consent of the parties, the trustee was directed to pay said dividends,

less the amount of claimed tax, which latter amount is retained by the trustee pending final determination of this cause.

Referee Friebolin disallowed the tax claim of the Government. The District Court affirmed the Referee, disallowing the tax claim. The Circuit Court of Appeals reversed the District Court, and allowed the tax claim.

REASON FOR GRANTING THE PETITION.

The Circuit Court of Appeals for the Sixth Circuit has decided an important question of Federal law which has not been, but should be settled by this Court.

Sections 57n and 64a of the Bankruptcy Act are preeminent provisions of the Bankruptcy Act, relied upon in practically every strict bankruptcy proceeding. The seriousness of the question presented herein stems from the evident fact that, if the case *sub judice* or *U. S. vs. Fogarty,* 164 F. (2d) 26, state the law, these two sections will be radically altered from their ordinary meaning by judicial construction.

Since the two Courts of Appeals differ in their determination of the status of the withholding tax, intelligent and safe administration will not be assured, unless and until the Supreme Court settles the question.

Section 57n provides for the manner of proving claims in strict bankruptcy. In a sentence, it requires all creditors to file proofs within six months of date of the first meeting of creditors. Originally, taxing authorities were not included among the claimants governed thereby. Said section was amended by the Chandler Act in 1938 to *include* claims of taxing authorities—with a provision for extension of time to them alone. This amendment was the result of a fairly general complaint by persons interested in efficient bankruptcy administration. Theretofore, taxing authorities were not required to file claims. The trustee had to seek them out. In consequence no estate could be safely

administered until the trustee in bankruptcy filed a petition requiring all taxing authorities to show cause why the funds should not be paid out as provided in Section 64a of the Act. This meant delay and expense.

If the decisions of the two courts, here questioned, are to govern, Section 57n will, in effect, be amended to exclude from necessity of filing proof, one kind of tax claim, viz: withholding taxes. On the other hand, if it could be said that a withholding is a "cost of administration" and not a claim for taxes, this would not be true. No proofs of claim, as required in Section 57n, need be filed for costs of administration, as such.

But the court in the case *sub judice,* although purporting to follow *U. S. vs. Fogarty,* refuses to hold, as did the latter case, that the withholding tax is a "cost of administration." We are left in the dark as to what its status is.

Now consider what the result is in attempting to follow the provisions of Section 64a. That section sets forth the order of payment of the free funds in an estate. Repeatedly the courts have held that there can be no deviation therefrom, even though there be "equitable grounds." 3 *Collier on Bankruptcy* (14 Ed.), 2058n.

Yet if the decisions in question remain unclarified, the trustee is confronted with a duty to pay withholding taxes in disregard to the commands of Section 64a. True, if the decision of *U. S. vs. Fogarty* is to prevail, the tax will be placed in Section 64a(1) as a "cost of administration." Just how it becomes a cost of administration is not clear. We can find no authority for holding that a claim not arising after bankruptcy by the act of an officer of the court, or by reason of some benefit conferred by a third person, can be a "cost of administration."

But, in the case *sub judice,* the court has refused to find that withholding tax is a "cost of administration"; yet the trustee is to pay it—deducting it from dividends declared upon claims based upon wages, no matter when

earned. We are left in the dark in what category such a tax is to be placed; under what head in Section 64a does it fall? It is not a "cost of administration" under Section 64a(1). It is not a "tax" entitled to priority under Section 64a(4). Obviously it is not a lien entitled to payment prior to all priorities.

This confusion should be dispelled by a ruling of the Supreme Court.

If it should be said that the trustee is not interested, that is, as trustee for general creditors, since the tax is deducted from dividends otherwise payable to the wage claimants, then surely, the court should not put the burden on the trustee to pay the tax regardless of any petition by the taxing authority for an order from the Bankruptcy Court to deduct it from the particular wage claimant with reasons therefor stated. In this petition, necessarily, the particular wage claimant would be made a party—after all it is his money that is proposed to be taken; it is *his* tax liability that is in question, i.e., the withholding tax is applicable upon the amount of taxes owing by *him—if any.*

It has always been the law that the Bankruptcy Court will not consider and determine collateral matters; conflicts between creditors of the bankrupt estate and creditors of such creditors, would delay administration, and are not within the purposes of bankruptcy. To hold otherwise would be seriously to interfere with administration and distribution. 3 *Collier* (14), p. 2296 n. 3.

In this case there are 117 wage claimants. If the decision *sub judice* is to be followed, what is the procedure? Is the trustee required to deduct from all 117 the arbitrary percentage fixed by the Internal Revenue rules as a withholding tax (where no exemption statement is filed) without notice to the wage claimants and hearing in order, first, to determine the liability, if any, of the wage claimant for the tax and, second, the amount thereof? The decisions in question furnish no answer. It would seem to be

quite clear that the trustee could not arbitrarily deduct and pay the amount claimed by the taxing authorities. The wage claimants are entitled to their day in court. In the case at bar that would mean, in effect, 117 lawsuits.

Surely, the Bankruptcy Court and its officers are entitled to be enlightened in a matter so vital and so replete with unusual consequences. See Prof. Robert Oglebay comments: "Some Developments in Bankruptcy Law," 23 *Journal of National Association of Referees in Bankruptcy* (1948), p. 14.

The decision of this Court on the questions here presented will dispel the present uncertainty and confusion. Stability and uniformity in the rules of everyday bankruptcy administration are desirable and necessary.

WHEREFORE, it is respectfully submitted that the within petition for writ of certiorari be granted.

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HOWARD R. HIRSCH,
Attorneys for Petitioner.

APPENDIX.

The pertinent portions of the Bankruptcy Act, enacted effective September 22, 1938, are as follows:

Section 64: Debts Which Have Priority—a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the filing fees paid by creditors in involuntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the Court may allow; (2) Wages, not to exceed Six Hundred Dollars ($600.00) to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt • • •

Section 57: Proof and Allowance of Claims; n. Except as otherwise provided in this Act, all claims provable under this Act, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided for in this section. Claims

which are not filed within six (6) months after the first date set for the first meeting of creditors shall not be allowed: Provided, however, that the Court may, upon application before the expiration of such period, and for cause shown, grant a reasonable fixed extension of time for the filing of claims by the United States or any State or subdivision thereof:

The provisions of the Current Tax Payment Act, Act of 1943, involved, are as follows:

Sec. 1621 (as added by Sec. 2, Current Tax Payment Act of 1943, *Supra*). Definitions.

As used in this subchapter—

(a) Wages—The term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash; except that such term shall not include remuneration paid—

* * * * *

(c) Employee—The term "employee" includes an officer, employee, or elected official of the United States, a State, Territory, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing. The term "employee" also includes an officer of a corporation.

(d) Employer—The term "employer" means the person for whom an individual performs or performed any service, of whatever nature, as the employee of such person, except that—

(1) if the person for whom the individual performs or performed the services does not have control of the payment of the wages for such services, the term "employer" (except for the purposes of subsection (a)) means the person having control of the payment of such wages; and

(2) in the case of a person paying wages on behalf of a non-resident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, the terms "employer" (except for the purposes of subsection (a)) means such person.

* * * * *

(26 U. S. C., 1946 ed., Sec. 1621.)

Sec. 1622 (as added by Sec. 2, Current Tax Payment Act of 1943, *supra*). Income Tax Collected At Source.

(a) Requirement of Withholding—Every employer making payment of wages shall deduct and withhold upon such wages a tax equal to the greater of the following:

(d) Tax Paid By Recipient—If the employer, in violation of the provisions of this subchapter, fails to deduct and withhold the tax under this subchapter, and thereafter the tax against which such tax may be credited is paid, the tax so required to be deducted and withheld shall not be collected from the employer; but this subsection shall in no case relieve the employer from liability for any penalties or additions to the tax otherwise applicable in respect of such failure to deduct and withhold.

* * * * *

(f) Refunds or Credits—

(1) Employers—Where there has been an overpayment of tax under this subchapter, refund or credit shall be made to the employer only to the extent that the amount of such overpayment was not deducted and withheld under this subchapter by the employer.

(2) Employees—For refund or credit in cases of excessive withholding, see section 322(a).

* * * * *

(26 U. S. C. 1946 ed., Sec. 1622.)

Sec. 1623 (as added by Sec. 2, Current Tax Payment Act of 1943, *supra*). Liability For Tax.

The employer shall be liable for the payment of the tax required to be deducted and withheld under this subchapter, and shall not be liable to any person for the amount of any such payment.

(26 U. S. C. 1946 ed., Sec. 1623.)